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THE INTERSTATE COMMERCE ACT AND THE SHERMAN ACT: PLAYING RAILROAD TYCOON

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I start my antitrust class each year with the Supreme Court's classic 1897 decision in *United States v. Trans-Missouri Freight Association*.¹ It is hard to imagine a better place to start. The case sits at the intersection of the two great late-nineteenth-century business law statutes: the Interstate Commerce Act (ICA) passed in 1887 and the Sherman Act passed in 1890.² And how often do you get to open a class with the question, "How would you run a railroad cartel?"

In the era leading up to the ICA and the Sherman Act, railroad pools and traffic associations were commonplace. No federal law sat as a barrier to a private agreement to establish the rules of competition among the members of the pool or association. Cartels today are forced to sneak around, and, one suspects, this means that the understanding of the cartel is rarely committed to paper by thoughtful lawyers. But the pools and associations of the second half of the nineteenth century were discussed openly and reported in newspapers as the ordinary affairs of business. Consider the report in the *New York Times*, on July 10, 1878, of the most recent gathering at Saratoga, New York, of the Vanderbilt family and business interests. The prospects for a pool organized around the New York Central Railroad were an active part of the discussions: "Some of the railroaders believe that a general pool will ruin the business, and about as many others say that a pool, if well adhered to, would bring things up wonderfully. Few believe, however, even if a general pooling arrangement should be made by the trunk lines, that it would be generally adhered to."³

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1. 166 U.S. 290 (1897).

2. Ch. 104, 24 Stat. 379 (1887); Ch. 647, 26 Stat. 209 (1890).

3. *A Vanderbilt Congress*, N.Y. TIMES, July 10, 1878.

This was the central problem of these arrangements. There is an incentive to cheat within cartels, and even though the agreements could be set out in great detail and often were, the agreements themselves weren't enforceable in court. It is one thing to stop short of condemning these agreements and something else to bring the force of the legal system to bear in enforcing them.

And yet the railroads continued to try. At the time that the ICA was passed, according to the agency that it established, there were eleven substantial traffic associations in place, covering the entire competitive railroad traffic in the United States. The post-Civil War period had seen an explosion in track miles from roughly 30,000 miles in 1860 to about 70,000 miles in 1873.⁴ The structure of competition quite literally embedded in the ground had shifted, and the railroads were struggling to create an institutional structure that matched it.

On March 15, 1889, the railroads that would comprise the Trans-Missouri Freight Association set out their agreement.⁵ Section 5 of the ICA had barred one institutional arrangement, the railroad pool.⁶ The pool was an effort to enforce cartel arrangements by requiring the sharing of revenues or profits. How much traffic a railroad received didn't really matter under a pool. What mattered was money, and if profits were split, competitive discipline would follow. The ICA took pools off of the table but was understood to have left room for other types of contractual arrangements, such as agreements on rates. Controlling those rates was the chief topic of the association agreement for the Trans-Missouri group.

The Trans-Missouri agreement was to go in effect on April 1, 1889, but with the passage of the Sherman Act on July 2, 1890, circumstances had changed dramatically.⁷ By the standards of modern statutes, the Sherman Act was a little nothing, barely a page-and-a-half in the Statutes at Large. (The ICA itself ran nearly nine pages.) But within two years, the federal government challenged the very existence of the freight association as a violation of Section 1 of the Sherman Act.

Of course, a central concern of the Interstate Commerce Act was rates. All charges were to be "reasonable and just," and if that wasn't

4. T.J. STILES, *THE FIRST TYCOON: THE EPIC LIFE OF CORNELIUS VANDERBILT* 366 (2009).

5. *Trans-Missouri Freight Ass'n*, 166 U.S. at 292 (statement of the case).

6. 24 Stat. at 380.

7. 166 U.S. at 304 (statement of the case).

sufficiently clear, the Act turned around and “prohibited and declared to be unlawful” “every unjust and unreasonable charge.”⁸ The Act barred unjust discrimination in rates and undue or unreasonable preferences and, in case it wasn’t already covered, specifically condemned short-haul/long-haul discrimination.⁹ The Sherman Act itself didn’t address rates directly at all, and antitrust’s own version of an anti-discrimination regime wouldn’t show up until 1914 in the Clayton Act (and then even more so in 1936 in the Robinson–Patman Act).¹⁰ All that Section 1 of the Sherman Act forbade was contracts in restraint of trade, and it said nothing about the reasonableness or unreasonableness of those restraints.

But what exactly was the mechanism by which the ICA’s not-too-hot, not-too-cold pricing regime was to emerge? In an industry populated by small firms, we expect atomistic competition to result in prices equal to average costs. Faced with monopoly, we can expect high prices and deadweight losses, but the railroads sat in that uncomfortable middle ground. The railroads knew—and argued to the Court in *Trans-Missouri*—that the competitive structure of railroads was perverse and needed something more than purely unbridled competition to sustain a healthy industry.¹¹ Railroads were a special-use property. They couldn’t easily be turned into something else if the railroad business turned out to be oppressively competitive. The railroads sought the opportunity to prove that their rates were reasonable—as required by the ICA—and that the association agreement was the mechanism to produce reasonable rates.

In the Supreme Court, the Trans-Missouri association argued that the railroad business had to be understood as exempt from the Sherman Act—that the much more specific Interstate Commerce Act, designed for railroads, had to control over the more general terms of the Sherman Act. Alternatively, assuming that the Sherman Act did indeed apply to them, the railroads wanted to contend that their restraints were acceptable under the Sherman Act given that they were necessary to produce the reasonable charges required under the ICA. Certainly,

8. Interstate Commerce Act § 1, 24 Stat. at 379.

9. *Id.* §§ 3, 4, 24 Stat. at 380.

10. Ch. 323, 38 Stat. 730 (1914); Ch. 592, 49 Stat. 1526 (1936).

11. *Trans-Missouri Freight Ass’n*, 166 U.S. at 310–11.

suggested the association, the Sherman Act didn't forbid all contracts in restraint of trade but just those that unreasonably restrained trade.¹²

In a 5–4 decision, the Supreme Court rejected both propositions. The Sherman Act was passed more than three years after the ICA, so it would have been easy enough for Congress to carve out the railroads from the new antitrust statute, but nothing like that had been done. And, in similar fashion, it would have been easy enough for Congress to expressly limit Section 1 of the Sherman Act to bar only unreasonable restraints of trade. Had this been done, the Court seemed to suggest, then the railroads would have been given the chance to prove that their agreement would “only keep rates up to a reasonable price.”¹³ But Section 1 barred all restraints of trade, both reasonable and unreasonable, and the agreement of the Trans-Missouri Freight Association was found to violate the Sherman Act.

What were the railroads to do? Railroad pools had been the preferred method for enforcing railroad cartels, but those were expressly barred by the ICA. Railroads had countered with the rate associations, which seemed to sidestep the ICA but were now condemned by the Sherman Act. The answer took two forms: seek more legislation and continue their practices much as they had before, notwithstanding the decision in *Trans-Missouri*.

As to legislation, the ICC reported in its twelfth annual report, dated January 11, 1899, that the railroads were seeking new legislation that they hoped would solve the problems that they had faced for the last half century.¹⁴ The railroads didn't want merely an exemption from the Sherman Act or a repeal of the anti-pooling provisions of the ICA. Instead, the railroads wanted the power to enter into rate and pooling agreements that would be enforceable in court—agreements with teeth.

In the meantime, the railroads tried to operate as they had before. The 1902 annual report of the Interstate Commerce Commission explained the realities of railroad life:

It is not the business of this Commission to enforce the antitrust act, and we express no opinion as to the legality of the means adopted by these associations. We simply call attention to the fact that the decision of the United States Supreme Court

12. *Id.* at 340.

13. *Id.*

14. 12 ICC ANN. REP. 14 (1899).

in the *Trans-Missouri* case and the Joint Traffic Association case has produced no practical effect upon the railway operations of the country. Such associations, in fact, exist now as they did before those decisions, and with the same general effect. In justice to all parties we ought probably to add that it is difficult to see how our interstate railways could be operated, with due regard to the interests of the shipper and the railway, without concerted action of the kind afforded through these associations.¹⁵

This was the first decade or so of the Interstate Commerce Act. How would the rate provisions of the Act be implemented? The Act itself was understood not to give direct rate-setting authority to the Interstate Commerce Commission.¹⁶ The railroads themselves tried to set rates through the traffic associations, much as they had tried to do with the pooling arrangements that had preceded the ICA. The result in *Trans-Missouri* seemed to bar those arrangements under the Sherman Act.

The path forward from there was complex and with many fits and starts. Legislation was proposed to amend the Sherman Act to limit Section 1 to barring unreasonable restraints of trade, but the Supreme Court itself rendered that unnecessary in 1911 in its “reinterpretation” of Section 1 in the *Standard Oil* case.¹⁷ On the railroad side, the 1920 Transportation Act finally gave the ICC rate-setting authority (even beyond the authority to determine maximum rates that the 1906 Hepburn Act provided).¹⁸ In 1948, with the passage of the Reed–Bulwinkle Act, the intersection of the ICA and the Sherman Act was finally dovetailed: The ICC was given the authority to approve carriers’ private agreements on rates, and that approval in turn conferred antitrust immunity on those arrangements.¹⁹

This was in many ways the path forward seen by the Interstate Commerce Commission as early as 1899. The commission both was familiar with life for railroads as it had been before the two great business acts and then had seen how those acts had worked together for

15. 15 ICC ANN. REP. 16 (1902).

16. See James. W. Ely, Jr., *The Troubled Beginning of the Interstate Commerce Act*, 95 MARQ. L. REV. 1131, 1133–34 (2012).

17. *Standard Oil Co. v. United States*, 221 U.S. 1 (1911) (holding that the Sherman Act proscribes only combinations that *unduly* restrain trade).

18. Ch. 91, § 416, 41 Stat. 456, 484 (1920); cf. ch. 3591, § 4, 34 Stat. 584, 589–90 (1906).

19. Ch. 491, 62 Stat. 472 (1948).

a decade culminating in the *Trans-Missouri* case in 1897 and the *Joint-Traffic Association* case in 1898.²⁰ The commission noted that “many thoughtful persons” believed that “unrestricted competition was inconsistent with the purposes aimed at” by the Interstate Commerce Act, and the commission was inclined to agree with them.²¹ The commission further noted that there was “no great nation at the present time which endeavors to enforce competition between its railways, although in many cases that method has been tried and abandoned.”²² Competition needed to be restricted and railroads needed to be allowed to accomplish this through agreement but subject to oversight by the commission to protect the public interest. Five decades later, the early vision of the commission was fulfilled. Of course, whether that was a good result is a question for another day.

20. *United States v. Joint Traffic Ass’n*, 171 U.S. 505 (1898).

21. 12 ICC ANN. REP. 19–20 (1899).

22. *Id.* at 20; see Paul Stephen Dempsey, *The Rise and Fall of the Interstate Commerce Commission: The Tortuous Path from Regulation to Deregulation of America’s Infrastructure*, 95 MARQ. L. REV. 1151, 1160 (2012).